

Canada's Cannabis Opportunity in the Era of Trump

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Although the United States government's attitudes toward cannabis have eased in recent years, the election of President Donald Trump has generated renewed uncertainty surrounding the future of the U.S. cannabis market. Canada, conversely, will very likely soon be one of the first industrialized countries with fully legalized recreational and medical cannabis, and investment in the Canadian cannabis market has been unprecedented. Unburdened by the U.S.'s significant political and legal uncertainty, Canada has an opportunity to expedite its already rapid industry development to position itself as a global leader in the market for legal recreational and medical cannabis products.

The United States cannabis market is beset with uncertainty

The United States has historically approached cannabis conservatively. Cannabis is currently illegal federally; it is classified as a Schedule 1 Substance under the *Controlled Substances Act of 1970*,¹ the schedule reserved for drugs said to be highly addictive and without medical value. However, under President Obama, the Department of Justice issued a memorandum in 2013 at the direction of United States Deputy Attorney General James Cole (the "Cole Memorandum") declaring that the federal government would take a state-centric, non-interventionist approach to the majority of local cannabis law enforcement issues if a given state legalized cannabis for recreational or medical purposes and implemented a "strong and effective regulatory and enforcement system" for its use and distribution.² This federal policy was reinforced by the passage of a 2015 federal budget bill (passed in 2014) that prohibits the use of federal funds to interfere in the implementation of state cannabis laws. This bill targets Department of Justice funding, which encompasses the Drug Enforcement Agency. This bill shows the development of bi-partisan support in the U.S. Congress for legalizing the use of cannabis.

The Cole Memorandum and related policy changes have created a grey area. The U.S. federal government continues to view cannabis as unambiguously criminal and has not retracted its right to enforce federal law where it deems it appropriate, yet there has not to date been a court decision clarifying the circumstances under which the federal government can control state markets; the Supreme Court declined to hear a challenge to Colorado's cannabis laws as recently as March 2016. In fact, there has been significant state-level legalization momentum. There are currently 28 states which allow access to some form of cannabis, 8 which allow or are proposing to allow access recreationally,³ and the District of Columbia has allowed for limited recreational use without provision for commercial sale. Additional states have tabled similar legislation for 2017. Unsurprisingly, the U.S. market for legal cannabis has grown in conjunction with legalization; it is expected to be worth \$7.1 billion in 2017 according to a 2016 report by New Frontier and ArcView market research.⁴

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Notwithstanding a growing zeitgeist in favour of legalization, the development of state-level legalization legislation remains subject to continued federal support for the “hands off” approach advocated in the Cole Report. However, continued support remains uncertain. President Trump did not campaign on an anti-cannabis strategy, and an administration focused on small government seems unlikely to abandon a state centric approach and potentially lucrative revenue stream, particularly when the share of Americans in favour of legalization continues to increase; as of 2016 57% of Americans favoured legalization, up from only 32% just a decade ago.⁵ However, key members of Trump's administration have engaged in strong anti-cannabis rhetoric. Senator Jeff Sessions, President Trump's Attorney General, is a longstanding and vocal cannabis legalization opponent. Vice President Mike Pence, spoke out against a 2013 bill to reduce severe penalties for simple possession while serving as governor of Indiana, a strict anti-cannabis state. Neil Gorsuch, President Trump's Supreme Court pick, does not have a clear position on the issue, however his hard-line stance on the criminal and textualist approach to legal interpretation may suggest a conservative approach to cannabis cases. In the case *Family of Ryan Wilson v City of Lafayette and Taser International*,⁶ for example, Gorsuch ruled that an officer was justified to assume that a person illegally growing cannabis may be armed, thus justifying the fatal use of a taser.

Any increase in uncertainty in an already unclear legislative environment functions as an impediment to cannabis projects in the U.S. Major banks and credit unions remain reluctant to capitalize or facilitate financial transactions for cannabis businesses due to fear of penalization for money laundering. Major U.S. stock exchanges prohibit the listing of cannabis companies, other than one ancillary company, Innovative Industrial Properties, a real estate investment trust that plans to invest in medical cannabis properties. Cannabis companies cannot take advantage of common corporate tax deductions,⁷ increasing the cost of doing business, and companies must be conservative when developing infrastructure in states with cannabis laws that may be subject to future federal scrutiny. Additionally, trademarks covering cannabis are generally not registrable at the federal level in the U.S., creating a challenge for U.S. companies in the protection of their intellectual property and branding efforts. Unless and until the US Government gives indication that a coherent legalization framework is in its legislative pipeline, growth potential in the U.S. cannabis market is necessarily limited.

Canada's cannabis market is ripe for growth

While the United States cannabis market struggles to determine its future, Canada is rapidly becoming an international leader in the market for cannabis. Canada's federal government is moving quickly to develop a comprehensive cannabis legalization framework. Medical cannabis is already legal at the federal level under the *Access to Cannabis for Medical Purposes Regulations* (“ACMPR”),⁸ and although recreational cannabis is still a Schedule II Narcotic under the *Controlled Drugs and Substances Act*,⁹ Prime Minister Justin Trudeau's government task force released a road map for the legalization of recreational cannabis by 2018-2019 last December, and the government expects to table legislation this spring. If this legislation is enacted, Canada will be the first G7 nation to fully legalize cannabis, for both medical and recreational purposes.

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In addition, Canada's legal cannabis licensing process is structured in a way that has encouraged the development of more sophisticated and better capitalized players than in other areas of the world. Canada currently limits the number of licenses available for producers ("Licensed Producers") under the ACMPR (to date only 38 have been issued),¹⁰ and such licenses are tied to specific pieces of production property. As such, companies are incentivized to license a large piece of property and build big, early. Canopy Growth Corp. ("Canopy"), for instance, started with the purchase of a 500,000 square foot chocolate factory for its licensed production site,¹¹ and Aphria Inc. ("Aphria") announced its intention in January 2017 to increase its already large 300,000 square foot capacity under the ACMPR to over 1,000,000 square feet.¹²

Importantly, better capitalization and favourable market environments have poised Canadian cannabis companies for international expansion. For example, in December 2016, PharmaCan Capital Corp., doing business as Cronos Group ("Cronos"), announced the execution of an exclusive supply agreement with German-based Pedianos GmbH for the distribution of medical cannabis in Europe.¹³ B.C.-based Tilray has recently become the first North American company to legally export cannabis to the European Union for commercial medical use and has also exported to Australia and Latin America, with approval to begin exporting to New Zealand. Canopy, as well, announced expansion into Australia in May 2016 through a partnership with AusCann Group Holdings.

The recent surge in cannabis-related activity in the Canadian capital markets has also been notable. Medical cannabis companies in Canada alone raised \$466 million on Canadian capital markets last year,¹⁴ and activity shows no sign of slowing, with over \$130 million raised by public Canadian Licensed Producers already in 2017. A recent report commissioned by Deloitte projects the Canadian recreational cannabis retail market to be worth \$4.9-\$8.7 billion annually, with the potential upside exceeding \$20 billion.¹⁵

The markets have been similarly active in terms of M&A activity. Canopy, for instance, is the result of a merger between Tweed Inc., Tweed Farms Inc., Bedrocan Canada Inc., and recently Mettrum Health Corp. Combined, Canopy may be the largest legal cannabis company in the world; it received a valuation of over \$1 billion in late 2016, and its current market cap is at almost \$2 billion. M&A and private equity activity on Canadian markets has not been limited to Canadian interests. Companies such as International Cannabis Corp. and CannaRoyalty Corp. have accessed the Canadian capital markets or listed themselves on Canada's stock exchanges.

In summary, Canada's more favourable regulatory environment has fostered better access to capital, more confident M&A activity and more rapid company growth in its legal cannabis market than its southern neighbours. Its market, as such, has been able to mature faster than the U.S., and, given the likelihood of a comprehensive legalization framework in the next year, this progress shows no signs of slowing. While the United States is unlikely to backpedal in its own recent progress toward cannabis legalization, the speed of its market growth in a rapidly developing industry is currently limited by its uncertain political and legal climate at the federal level. Canada, as such, has an opportunity to leverage its already larger and more

sophisticated players to attract top talent, establish presence as a research and development leader and grow its international industry presence to become a global leader in the market for legalized cannabis.

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¹ *Controlled Substances Act of 1970*. Pub L No. 91-513, 84 Stat 1242.

² Cole, James, "Memorandum from the U.S. Department of Justice, Office of the Deputy Attorney General to all United States Attorneys, Subject: Guidance Regarding Marijuana Enforcement" *Office of Public Affairs*, online: August 29, 2013 <<https://www.justice.gov/opa/pr/justice-department-announces-update-marijuana-enforcement-policy>>.

³ Washington, Colorado, Alaska, Oregon, California, Massachusetts, Nevada and Maine.

⁴ John Kajia & Sam Osborn, eds, "The State of Legal Marijuana Markets Executive Summary: 4th Edition", *ArcView Market Research and New Frontier Data*, online: 2016 <<http://mjardin.com/wp-content/uploads/2016/05/Executive-Summary-State-of-Legal-Marijuana-Markets-4th-Edition-1.pdf>>.

⁵ Abigail Geiger, "Support for marijuana legalization continues to rise", <<http://www.pewresearch.org/fact-tank/2016/10/12/support-for-marijuana-legalization-continues-to-rise/>>.

⁶ 10th Cir. R. 32.1, online: <<http://www.ca10.uscourts.gov/opinions/11/11-1403.pdf>>.

⁷ Section 280E of the IRS code prohibits businesses from deducting expenses from trafficking of a controlled substance, which in turn precludes cannabis businesses from deducting for cost of goods sold.

⁸ SOR/2016-230.

⁹ SC 1996, c 19.

¹⁰ "Authorized Licensed Producers for Medical Purposes", *Health Canada*, online: Feb 7, 2017 <<http://www.hc-sc.gc.ca/dhp-mps/marihuana/info/list-eng.php>>.

¹¹ "Welcome to Canopy Growth", *Canopy Growth Corporation*, online: <<https://www.canopygrowth.com/>>.

¹² "Aphria's Vision to be Reality – Part IV expansion project to increase greenhouse growing space to 1 million square feet" Aphria, online: January 17, 2017 <https://aphria.com/assets/reports/APH_-_2017_01_January_16_-_Part_IV1.pdf>.

¹³ "Canada's Cronos Group Signs Deal to Supply Medical Cannabis in Europe" *PharmaCan Capital Corp* online: December 29 2016 <<https://www.pharmapro.com/news/2016/12/canadas-cronos-group-signs-deal-supply-medical-cannabis-europe>>.

¹⁴ Sunny Freeman, "Why smaller banks take bigger slice of the growing medical marijuana business", *Financial Post*, online: January 30 2017, <<http://business.financialpost.com/news/fp-street/why-smaller-banks-take-bigger-slice-of-the-growing-medical-marijuana-business>>.

¹⁵ "Recreational Marijuana: Insights and Opportunities" *Deloitte*, online: 2016 <https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/Analytics/ca-en-analytics-DELOITTE%20Recreational%20Marijuana%20POV%20-%20ENGLISH%20FINAL_AODA.pdf>

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